

RULES OF  
DEPARTMENT OF REVENUE

CHAPTER 810-3-35.1

Assessment of Income Taxes - Deduction for a  
Limited Net Operating Loss Carryforward  
for Corporations

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810-3-35.1-.01 Carryforward of Net Operating Losses for Corporations - General.

(1) In addition to the deductions allowed to corporations by §40-18-35, a deduction is also allowed for net operating losses carried forward from any year which began after December 31, 1983.

(2) The term "net operating loss" means the excess of deductions (other than the net operating loss carryforward) allowed by Chapter 18, Title 40, Code of Alabama 1975, over the gross income.

(3)(a) For any tax year that begins after December 31, 1983, but before January 1, 1985, the loss may be carried forward for a maximum of five (5) years or until exhausted. For all tax years beginning after December 31, 1984, losses may be carried forward for a maximum of fifteen (15) years or until exhausted. A loss must be carried first to the earliest year in which the corporation has net income (determined without taking into account the loss carryforward). The excess, if any, may then be carried forward to the next earliest year, in succession, in which the corporation has net income. Any years in which the corporation had elected to be an Alabama S corporation are included within the maximum carryforward limitation of five or fifteen years, as well as any "year" of less than twelve months (as outlined in subparagraph (b) below).

(b) The term "year" includes a period of less than twelve months (short-year) resulting from a change in accounting period pursuant to §40-18-30. Thus, a short-year loss may be carried to a succeeding full year, or a full year loss may be utilized in a short-year.

(4) The loss for any year is to be computed under the law applicable to that year.

(5) In computing the amount of a net operating loss available for carryforward, certain adjustments must be taken into account.

(a) Due to the limitation on the charitable contributions deduction of §40-18-35(10), contributions may not form part of a net operating loss carryforward. For tax years beginning on or after January 1, 1985, excess contributions may be carried forward for a maximum of five years. See Rule 810-3-35-.01(3)(j).

(b) The net operating loss will be increased by the amount of any federal income tax accrued (or reduced by the amount of any refund) attributed to the corporation for the loss year.

(c) The amount available for carryforward must be reduced by the amount of any loss deduction which was available for use, even if not actually

used. No adjustment will be required under this subparagraph for years in which the corporation had in effect an election to be an Alabama S corporation.

(6) (a) For tax years beginning before January 1, 1990, the maximum amount of net operating loss carryforward which may be utilized in any year is \$600,000. The excess, if any, may continue to be carried forward not to exceed the time limitations in paragraph (3) above. The net operating loss deduction utilized cannot create a net operating loss - that is, the result, after subtracting the net operating loss carryforward cannot be less than zero.

(b) For tax years beginning after December 31, 1989, the \$600,000 limitation for subparagraph (a) no longer applies.

(7) EXAMPLE:

Income	1,000,000	4,000,000	3,500,000
Expenses (except contributions)	2,400,400	2,000,000	2,400,000
Contributions	100,000	100,000	100,000
Totals	(1,500,000)	1,900,000	1,000,000
Contributions adjustment	<u>100,000</u>	<u>-0-</u>	<u>-0-</u>
Income before Federal Tax Deduction	(1,400,000)	1,900,000	1,000,000
Federal Tax (Deduction/Refund)	<u>400,000</u>	<u>(500,000)</u>	<u>(300,000)</u>
Taxable Income/Net Operating Loss)	(1,000,000)	1,400,000	700,000
Net Operating Loss Carryforward	<u>1,000,000</u>	<u>(600,000)</u>	<u>(400,000)</u>
Net Taxable Income	<u>-0-</u>	<u>800,000</u>	<u>300,000</u>

(8) A net operating loss carryforward deduction may only be utilized by the corporation which incurred the loss. A corporation, resulting from a reorganization will be considered to have incurred the losses not utilized by the parties to a reorganization in a transaction described in sections 1., 2., 5. and 6. of Rule 810-3-80-.04(1)(a). The limitations on the maximum carryforward period

and the ordering rules for multiple losses in paragraph (3) above, will be applied to the carryforwards after the reorganization as if the reorganization had not taken place. The limitation on the maximum amount of net operating losses which may be deducted in a taxable year in paragraph (6) above will be applied to the total of all carryforwards resulting from a reorganization.

(9) In the case of an acquiring corporation subject to the rules of 26 U.S.C. §381, or in the case of a new loss corporation within the meaning of 26 U.S.C. §382, or in the case of the recognized built-in gains of a gain corporation within the meaning of U.S.C. §384, only such net operating losses as are allowable in accordance with said U.S.C. §§381, 382, and 384 shall be allowed as a deduction under this section. This paragraph shall be applied before the limitations in this preceding example are applied.

(10) A net operating loss from any year in which the corporation had elected to be an Alabama S corporation may not be carried forward. See Rule 810-3-168-.01.

Author: Voncile Catledge, Individual and Corporate Tax Division  
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810-3-35.1-.02      Carryforward of Net Operating Losses for Corporations  
Apportioning and Allocating Income.

(1) (a) For corporations apportioning and allocating income to Alabama, the amount of a net operating loss to be attributed to Alabama will be computed in the manner provided in §40-18-33, Code of Alabama, 1975, and modified as provided in the Multistate Tax Compact, Chapter 27, Title 40, Code of Alabama 1975.

(b) In other words, a corporation apportioning and allocating income to Alabama will have a net operating loss attributed to Alabama if the sum of the following items is less than zero:

1. the income (or loss) apportioned to Alabama,
2. the income (or loss) allocated to Alabama,
3. any deductions allocated to Alabama (such as pollution control capital expenditures),
4. any federal income tax attributed to the corporation which is apportioned to Alabama income (this usually will be -0- because the federal tax apportionment factor will have -0- as either the numerator, the denominator or both), and
5. any overpayment of federal income tax previously taken as a deduction in Alabama returns for prior periods which is attributable to the taxpayer for the loss year.

(2) For a corporation apportioning and allocating income, the net operating loss attributed to Alabama will be treated as allocated to Alabama in the year utilized. That is, income (including the deduction for charitable contributions and the federal income tax deduction) for the year of utilization will first be computed as provided in §§ 40-18-33 and 40-27-1, and the net operating loss deduction then will be subtracted to determine taxable income.

Author: Voncile Catledge, Individual and Corporate Tax Division  
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810-3-35.1-.03 Carryforward of Net Operating Losses for Corporations Filing Alabama Consolidated Returns.

(1) Corporations filing Alabama Consolidated Income Tax Returns will compute the net operating loss attributed to Alabama in the manner provided in Rules 810-3-31-.01 and 810-3-31-.02.

(2)(a) The deductibility of net operating losses incurred in a tax year before a corporation becomes a member of an Alabama affiliated group and elects to file an Alabama consolidated return is limited in accordance with the separate return limitation year (SRLY) rules contained in 26 U.S.C. §1502.

1. The term “separate return year” means a taxable year of a corporation for which it files a separate return or for which it joins in the filing of a consolidated return by another group.

2. The term separate return limitation year (or SRLY) means any separate return year of a member or of a predecessor of a member.

3. The term separate return limitation year (or SRLY) does not include:

(i) A separate return year of the corporation, which is the common parent for the consolidated return year to which the tax attribute is to be carried,

(ii) A separate return year of any corporation which was a member of the group for each day of such year, or

(iii) A separate return year of a predecessor of any member if such predecessor was a member of the group for each day of such year.

4. The term “group” means an affiliated group of corporations as defined in 26 USC §1504.

5. The term “member” means a corporation (including the common parent) that is included in the group, or as the context may require, a corporation that is included in a subgroup.

6. The term “predecessor” means a transferor or distributor of assets to a member (the successor) in a transaction -

(i) To which section 381(a) applies; or

(ii) That occurs on or after January 1, 1997, in which the successor’s basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the assets of the transferor or distributor, but in the case

of a transaction that occurs before June 25, 1999, only one member may be considered a predecessor to or a successor of one other member.

(b) The aggregate of the net operating loss carryovers of a member arising in SRLYs that are included in the consolidated net operating loss deductions for all consolidated return years of the group under paragraph (1) of this section may not exceed the aggregate consolidated taxable income for all consolidated return years of the group. For this purpose:

1. Consolidated taxable income is computed without regard to consolidated net operating loss deductions;

2. Consolidated taxable income takes into account the member's losses and deductions actually absorbed by the group in consolidated return years;

3. In computing consolidated taxable income, the consolidated return years of the group include only those years, including the year to which the loss is carried, that the member has been continuously included in the group's consolidated return, but exclude any years ending after the year to which the loss is carried.

(c) EXAMPLE: 1. In Year 1, corporation P sustains a \$40 net operating loss that is carried forward. P has no income in Year 2. Unrelated corporation T sustains a net operating loss of \$50 in year 2 that is carried forward. P buys the stock of T during Year 3, but T is not a member of the P group for each day of the year. P and T file separate returns and sustain net operating losses of \$120 and \$60, respectively, for Year 3. The P group files consolidated returns beginning in Year 4. During Year 4, the P group has \$160 of consolidated taxable income (computed without regard to the consolidated net operating loss deduction). The consolidated taxable income would be \$70 if determined by reference to only T's items. These results are summarized as follows:

	Separate Year 1	Separate/ Affiliated Year 2	Consolidated Year 3	Year 4
P	\$(40)	\$ 0	\$(120)	\$ 90
T	\$ 0	\$(50)	\$( 60)	\$ 70
CAI				\$160

2. P's Year 1, Year 2, and Year 3 are not SRLYs with respect to the P group. P's \$40 net operating loss arising in Year 1 and \$120 net operating loss arising in Year 3 are not subject to the SRLY limitation. The loss arising in Year 1 is the first loss that the P group must absorb in Year 4. Absorption of this loss

leaves \$120 of the group's consolidated taxable income available for offset by other loss carryovers.

3. T's Year 2 and 3 are SRLYs with respect to the P group. T's \$50 net operating loss arising in year 2 and \$60 net operating loss arising in Year 3 are subject to the SRLY limitation. Under paragraph (2)(b) of this section, the SRLY limitation for Year 4 is \$70. T's \$50 loss from year 2 must be included in the P group's consolidated net operating loss deduction for year 4. The absorption of this loss leaves \$70 of the group's consolidated taxable income available for offset by other loss carryovers.

4. P and T each carry over net operating losses to Year 4 from a taxable year ending on the same date (Year 3). The losses carried over from Year 3 total \$180. Under paragraph (b) of this section, the losses carried over from Year 3 are absorbed on a pro rata basis, even though one arises in a SRLY and the other does not. However, the group cannot absorb more than \$20 of T's \$60 net operating loss arising in Year 3 because its \$70 SRLY limitation for Year 4 is reduced by T's \$50 Year 2 SRLY loss already included in the consolidated net operating loss deduction for Year 4. Thus, the absorption of Year 3 losses is as follows:

Amount of P's Year 3 losses absorbed =  $\$120/(\$120 + \$20) \times \$70 = \$60$

Amount of T's Year 3 losses absorbed =  $\$20/(\$120 + \$20) \times \$70 = \$10$ .

5. The absorption of \$10 of T's Year 3 loss further reduces T's SRLY limitation to \$10 (\$70 of initial SRLY limitation, reduced by the \$60 net operating loss already included in the consolidated net operating loss deductions for Year 4 under paragraph (a) of this section).

6. P carries its remaining \$60 Year 3 net operating loss and T carries its remaining \$50 Year 3 net operating loss over to Year 5. Assume that, in Year 5, the P group has \$90 of consolidated taxable income (computed without regard to the consolidated net operating loss deduction). The group's consolidated taxable income determined by reference to only T's items is a consolidated net operating loss of \$4. For Year 5, the consolidated net operating loss deduction includes \$60 of P's Year 3 loss but only \$6 of T's Year 3 loss (the aggregate consolidated taxable income for Years 4 and 5 determined by reference to T's items, or \$66, reduced by T's SRLY losses actually absorbed by the group in Year 4, or \$60).

(d) If any consolidated net operating loss that is attributable to a member may be carried to a separate return year of the member, the amount of the consolidated net operating loss that is attributable to the member is apportioned to the member (apportioned loss) and carried to the separate return



year. If carried over to a separate return year, the apportioned loss may not be carried over to an equivalent, or later, consolidated return year of the group.

1. The amount of a consolidated net operating loss that is attributable to a member is determined by a fraction the numerator of which is the separate net operating loss of the member for the year of the loss and the denominator of which is the sum of the separate net operating losses for that year of all members having such losses.

(e) If a corporation ceases to be a member during a consolidated return year, net operating loss carryovers attributable to the corporation are first carried to the consolidated return year, and only the amount so attributable that is not absorbed by the group in that year is carried to the corporation's first separate return year.

(f) In determining net operating loss carryovers for SRLY subgroups where an existing Alabama affiliated group acquires another affiliated group, the limitations on net operating loss carryovers from a SRLY apply to the SRLY subgroup and not to its members. In determining the members of a SRLY subgroup with respect to the carryover of a net operating loss, the SRLY subgroup is composed of the member carrying over the loss (the loss member) and each other member that was a member of the former group that becomes a member of the new group at the same time as the loss member.

(3) The limitation provided in paragraph (2) of this section does not apply to net operating loss carryovers when the application of paragraph 2 of this section results in an overlap with the application of 26 U.S.C. §382.

(a) An overlap of §382 with respect to a net operating loss occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a §382 limitation with respect to that carryover (the §382 event).

(b) If an overlap of this section occurs with respect to net operating loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a §382 event then an overlap is treated as also occurring with respect to that corporation's net operating loss carryover that arises within the period beginning with the §382 event and ending with the SRLY event.

Author: Voncile Catledge

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